Working paper

Tapping the potential of borrower-led multilateral development banks

Chris Humphrey

January 2023

Key messages

Borrower-led multilateral development banks (MDBs) have the potential to play a larger role in tackling global challenges, but they are often overlooked in the international development agenda.

Governance control by borrower countries leads to different characteristics from legacy MDBs, notably closer alignment with the principles of country ownership but more difficult access to funding.

Several borrower-led MDBs in Latin America, Africa and Eastern Europe/Central Asia have grown very quickly in recent years, driven by internal reforms and improved access to bond market financing.

Some borrower-led MDBs are able to react quickly to crises like the Covid-19 pandemic and the Ukraine conflict, and are adapting to changing priorities such as a greater emphasis on sustainable infrastructure.

Bilateral aid agencies, legacy MDBs and impact investors should seek opportunities to work more with borrower-led MDBs to better leverage their potential to address global development needs.

The Rockefeller Foundation

How to cite: Humphrey, C. (2023) *Tapping the potential of borrower-led multilateral development banks*. ODI Working paper. London: ODI (www.odi.org/en/publications/tapping-the-potential-of-borrower-led-multilateral-development-banks).

Acknowledgements

The author gratefully acknowledges inputs from Panayotis Gavras (Head, Policy and Strategy, BSTDB), Miguel Ostos (Director of Operations Programming, CAF), Abraham Byanyima (Treasurer, TDB) and Antonina Kayitesi (Associate Executive, Treasury and Financial Management, TDB), as well as peer reviewers Samantha Attridge and Annalisa Prizzon (ODI) and Dr Ben Cormier (University of Strathclyde). Ivo Popov at ETH Zurich provided excellent assistance with research and data collection. Thanks also to Gruffudd Owen of ODI for his timely production support. All errors, omissions and opinions are solely those of the author.

About this publication

Funding for this research was provided by the Rockefeller Foundation via the ETH Zurich Center for Development and Cooperation.

About the author

Chris Humphrey is a senior research associate at ODI and a senior scientist at the ETH Zurich Center for Development and Cooperation.

Contents

Display items

Tables

Figures

Acronyms

AfDB	African Development Bank
AIIB	Asian Infrastructure Investment Bank
BCBS	Basel Committee on Banking Supervision
BOAD	West African Development Bank
BSTDB	Black Sea Trade and Development Bank
CABEI	Central American Bank for Economic Integration
CAF	Development Bank of Latin America
DFI	development finance institution
EADB	East African Development Bank
EBID	Economic Community of West African States (ECOWAS) Bank for Investment and Development
EDB	Eurasian Development Bank
EIB	European Investment Bank
EMDE	emerging market and developing economies
EU	European Union
FONPLATA	Financial Fund for the Development of La Plata Basin
GDP	gross domestic product
IDA	International Development Association
IDB	Inter-American Development Bank
IMF	International Monetary Fund
IsDB	Islamic Development Bank
MIGA	Multilateral Investment Guarantee Agency
MDB	multilateral development bank
NDB	New Development Bank
S&P	Standard and Poor’s
TDB	Trade and Development Bank

Executive summary

About 30 multilateral development banks (MDBs) operate across the globe today. While the World Bank and major regional MDBs (the ‘legacy’ MDBs) have a high profile, most MDBs are less well known. In light of the serious challenges facing the world and the limitations of other development agencies, it should be a priority to integrate these MDBs into the international agenda and strengthen their capacity.

Although most borrower-led MDBs remain relatively small, they are growing rapidly. The outstanding loan portfolios of 10 borrower-led MDBs grew from $7.2 billion to $73.4 billion between 2000 and 2021 – a 920% increase over two decades. Growth has been led by the Development Bank of Latin America (CAF), the Central American Bank for Economic Integration (CABEI), Afreximbank, the Trade and Development Bank (TDB) and the West African Development Bank (BOAD). The Black Sea Trade and Development Bank (BSTDB), the Eurasian Development Bank (EDB) and the Financial Fund for the Development of La Plata Basin (FONPLATA) have grown more modestly, while the Economic Community of West African States (ECOWAS) Bank for Investment and Development (EBID) and the East African Development Bank (EADB) remain small.

This paper provides an overview of the governance, operational and financial characteristics of 10 borrower-led MDBs operating in low- and middle-income countries, offers three case studies highlighting their innovations and developmental potential and proposes policy options to help improve the effectiveness of these MDBs.

This is the first in a series of studies on borrower-led MDBs. Upcoming papers will examine in more detail the challenges and opportunities faced by borrower-led MDBs, linking their governance with their financial context and operational attributes.

Trade-offs of borrower-led governance

The 10 MDBs examined here are owned and controlled by borrower countries themselves, with little or no governance input from wealthy donor countries. This gives these MDBs unique operational characteristics. On the one hand, they are much closer to the country ownership agenda embodied by the Accra Agenda for Action (2008) and the Busan Partnership (2011). On the other hand, their governance profiles pose a number of challenges to developmental effectiveness.

The immediate causal channel is financial. The fact that these MDBs are owned by emerging market and developing countries (EMDEs) makes them appear less creditworthy in the eyes of capital markets and commercial banks, increasing their cost of funding and, in turn, making their development loans more expensive and with shorter repayment periods. These MDBs also tend to have modest share capital, restricting their operational capacity. This impacts demand for their services and the kind of projects they can support. It also incentivises these MDBs to keep administrative costs down, limiting their ability to offer useful technical support and expertise along with their financing. Improved bond ratings in recent years are helping, but funding pressures remain a major issue.

On the other hand, control by borrower countries brings a number of benefits. These MDBs intimately understand the realities of their EMDE members and have close relations with member governments. They align with and respond to government needs, and they are not inclined to impose their own vision for development in ways that legacy MDBs at times do. They are fast, unbureaucratic and flexible in response to evolving circumstances and recipient priorities. Borrower-led MDBs are well-adapted to changing geopolitical circumstances, providing a forum for EMDEs to build relationships and work on practical problems with one another on their own terms.

Case studies highlight developmental potential of borrower-led MDBs

Three case studies of borrower-led MDBs help illustrate innovations and potential roles for these MDBs as part of the international development finance landscape.

- BSTDB was founded in 1997 and was on a steady upward trajectory before the onset of the Ukraine conflict in the centre of its operating region. It is well-placed to play a part in helping the region recover from the conflict.
- TDB in eastern and southern Africa has grown rapidly since 2000. It has piloted a series of innovations, including taking on commercial investors as minority shareholders. In 2020, it benefited from over $800 million in direct financing and guarantees from the World Bank Group, a recognition of TDB’s effectiveness.
- CAF is a model for other borrower-led MDBs, now lending as much or more than the legacy MDBs in Latin America. It responded rapidly to the Covid-19 pandemic with substantial resources. CAF has begun moving more towards green and sustainable investments, and has started accessing green and social bond markets to help diversify funding options.

Policy options

Bilateral aid agencies, legacy MDBs, international philanthropies and impact-oriented investors can all help borrower-led MDBs play a bigger role For legacy MDBs and bilateral aid agencies seeking to support borrower-led MDBs, it is important to strike the right balance between encouraging increased development impact while avoiding top-down imposition on how these MDBs operate.

Options to support borrower-led MDBs, especially in relation to their constrained financial capacity, include:

- Most borrower-led MDBs already benefit from official credit lines, but they could be scaled up substantially, particularly from bilateral aid agencies and legacy MDBs.
- Co-financing projects with legacy MDBs and bilateral aid agencies helps strengthen the capacity of borrower-led MDB staff and de-risk their loan portfolios. Syndication and loan sales with commercial institutions, including impact investors, offer similar benefits.
- Risk transfer operations can be done in cooperation with legacy MDBs (via exposure exchange operations) or with commercial counterparties (via credit insurance or synthetic securitisation).
- External partners can contribute share capital to borrower-led MDBs as full members or in a subordinated share class with reduced voting rights but receiving dividends.
- Legacy MDBs and other international actors should coordinate with borrower-led MDBs on relevant aspects of the development agenda, taking advantage of their local presence and strong relationships with member governments.
- The Basel Committee on Banking Supervision (BCBS) should incorporate borrower-led MDBs into Basel III regulations related to asset risk weighting and the International Monetary Fund (IMF) should exempt their loans from sovereign debt restructuring (as with the legacy MDBs) to preserve their preferred creditor status.

1 Introduction

Around 30 MDBs operate across the world today. Most are little-known and rarely taken into account in the international development agenda,[1] but they have been establishing themselves as development financiers across the world. CAF, CABEI, TDB, BOAD and BSTDB, among others, provide development finance services that complement the activities of the better-known 'legacy' MDBs.

These MDBs are controlled by the same countries in which they operate, with minimal or no influence of high-income nations. This gives them a particular set of operational characteristics. They are much closer to the 'country ownership' agenda espoused by international development accords such as the Accra Agenda for Action (2008) and the Busan Partnership (2011). On the other hand, their governance profile poses some challenges, particularly in relation to finance. Although these borrower-led MDBs remain small compared to the legacy MDBs, they are growing very rapidly – an indication that their attributes are valued by their members.

This paper highlights the developmental potential of these institutions, points out some of the challenges they face and proposes ways that other international actors can help them realise their potential. Due to the urgency of global development challenges, it is imperative that borrower-led MDBs be more integrated in the international development agenda. Despite some weaknesses, these MDBs bring a unique set of attributes and relationships to the table that can be a valuable complement to other international development actors.

The paper begins with an overview of 10 MDBs, including their governance arrangements, financial and operational characteristics and recent trajectory. Next, the paper presents brief case studies of three borrower-led MDBs, one from Africa (TDB), one in Latin America (CAF) and one in Eastern/Central Europe (BSTDB). The paper concludes with policy options geared to donor-country governments, legacy MDBs, major philanthropies and impact-oriented investors.

Evidence for this paper was gathered in the first instance from publicly available documents from the 10 MDBs, including annual

[1] Two noteworthy exceptions are the Finance in Common network (financeincommon.org) and the International Development Finance Club (idfc.org). One recent publication that focuses on bilateral development finance institutions but also includes borrower-led MDBs is Attridge and Novak (2022). An earlier policy study highlighting borrower-led MDBs is Institute for Development Studies (2000).

reports, annual financial statements, institutional strategy documents and investor presentations, supplemented with some secondary sources, notably credit rating agency reports. Further information was obtained via in-depth interviews with senior management of BSTDB, CAF and TDB.

2 What is a borrower-led MDB?[2]

Much previous analysis has divided MDBs into three groupings based on geography: global, regional and sub-regional. Although a useful shorthand, this categorisation is increasingly outdated. For example, CAF and TDB have both expanded membership well beyond their original ‘sub-region’, but they are very different from the ‘regional’ Inter-American Development Bank (IDB) and African Development Bank (AfDB).[3] Similarly, the recently-created Asian Infrastructure Investment Bank (AIIB) and New Development Bank (NDB) are open for global membership but do not seem to belong in the same category as the World Bank.

This paper utilises governance rather than geography as the key categorising factor. Because borrower member governments tend to have policy priorities and interests that systematically differ from non-borrower member governments (Humphrey 2022a), governance control by borrowers systematically differentiates these MDBs from those predominately controlled by wealthy non-borrower governments. The varying interests between these two sets of countries is a tendency rather than a rule, but it is analytically useful to highlight systematic differences across MDBs.

Borrower-led MDBs have the same core organisational and operational model as the legacy MDBs. They were all created by international treaty among a group of sovereign nations, are funded with share capital contributed by each member, obtain further resources by borrowing from external sources and make loans[4] for developmental purposes. They are all run by a management team that is accountable to boards of directors and boards of governors comprised of member country representatives. Their founding statutes are very similar to the legacy MDBs, in many cases using nearly identical language on key governance and operational rules.

[2] Three recent works providing descriptions and data on borrower-led MDBs in comparison to legacy MDBs include Delikanli et al. (2018), Bazbauers and Engel (2021) and Humphrey (2022a).

[3] Borrower member countries have a majority of voting power at both of these regional MDBs. Nonetheless, as several researchers (for example Babb, 2009) convincingly show, special majority voting rules and dependence on concessional donations, respectively, give non-borrower shareholders *de facto* control over major policies. Non-borrowers have *de jure* voting control at the European Bank for Reconstruction and Development or the Asian Development Bank.

[4] Some MDBs also makes use of other financial instruments, such as guarantees and equity investments, but loans make up the bulk of operations at all MDBs.

This paper focuses on a set of 10 borrower-led MDBs operating in lower- and middle-income countries (Table 1 Overview **of 10 borrower-led MDBs**Seven other borrower-led MDBs fitting these criteria were not included for a variety of reasons.[5] MDBs focused on higher-income countries, such as the European Investment Bank (EIB),[6] the Council of Europe Development Bank or the Nordic Investment Bank, are excluded. Nor are the newly created AIIB or the NDB examined, due to the geopolitical complexity they embody and their already high profile in the international arena.[7]

[5] This includes the International Investment Bank (currently in a membership crisis following Russia's invasion of Ukraine), the ECO Trade and Development Bank, the Central African States Development Bank and the Development Bank of the Great Lakes Region (uncertain financial viability and limited or no information), the Pacific Islands Development Bank (very small size and limited development focus), the Arab Bank for Economic Cooperation in Africa (only lends to countries that are not members of the bank) and the Islamic Development Bank (IsDB) (difficulty of comparing Islamic financing structures to other MDBs). Their exclusion from this paper is not meant to downplay their developmental importance, which can be considerable. For example, IsDB just committed $4.3 billion in financing as part of international support to Pakistan's flood recovery (IsDB, 2023).

[6] About 10% of EIB's portfolio is in non-European Union (EU) countries, but none of those recipient countries are EIB members, leading to a unique governance dynamic. EIB is in some ways more akin to a national development bank for the EU than a multilateral.

[7] The question of rising middle-income nations creating their own MDBs – most notably China as the founder of AIIB and the co-founder with other nations of NDB – may well end up creating a new category of MDB that has attributes of both legacy MDBs and borrower-led MDBs, as discussed in Humphrey (2022a). For more on AIIB and NDB governance, see, among others, Chin (2014 and 2019), He (2016), Serrano (2019) and Wang (2019).

Table 1 Overview of 10 borrower-led MDBs

	Launch year	Sovereign members	Borrower voting power	Disbursed portfolio ($ m.)	2021 financing approvals ($ m.)
Africa					
TDB	1985	25	82.5%	5,632	Not available
BOAD	1976	15	93.4%	4,154	762
EBID	1979	15	100%	966	709
EADB	1967	6	87%	160	72
Afreximbank	1993	38	Not available*	18,176	14,973
Americas					
CAF	1970	19	100%	29,365	13,192
CABEI	1960	15	64.1%	8,618	3,690
FONPLATA	1974	5	100%	1,504	401
Eastern Europe/Central Asia					
EDB	2006	6	100%	2,230	1,637
BSTDB	1999	11	100%	2,684	929

Note: Afreximbank does not report the full breakdown of all 153 shareholders (as of end 2021). Of the top 20 shareholders, only one (China Ex-Im Bank, the seventh-largest shareholder) is a non-African government.

Source: Annual reports, financial statements, investor presentations

2.1 Governance of borrower-led MDBs[8]

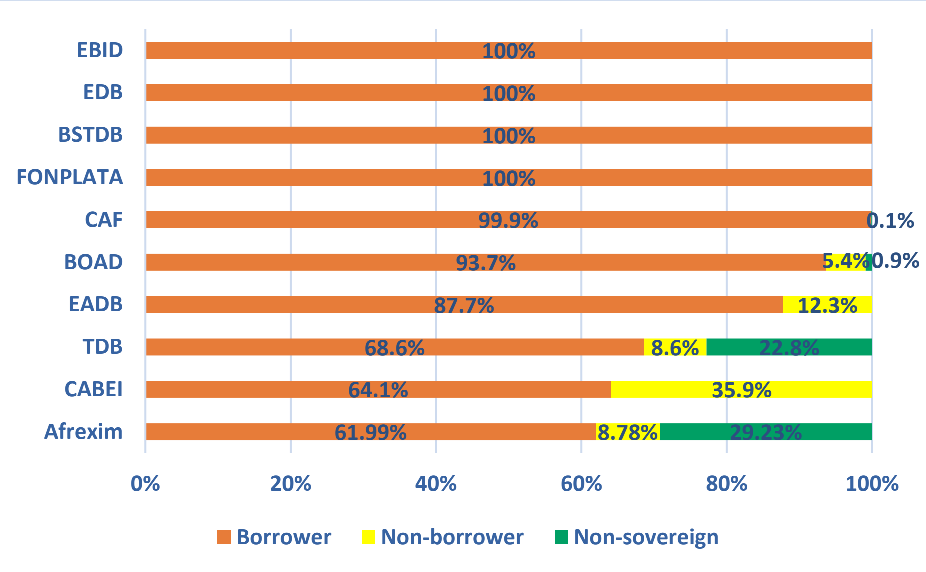
Borrow-led MDBs are controlled by EMDEs, which tend to share similar policy priorities of relevance to how an MDB operates. This governance profile is the single most important factor explaining why these MDBs tend to be similar to one another in operational terms and different from the legacy MDBs.

Of the 10 MDBs considered here, five have non-borrower countries in their shareholding structure, although always in a minority position (Figure 1). In the case of Afreximbank and TDB, these include other EMDEs such as China and India, which tend to have interests closely aligned with borrower nations. BOAD has China, India and Morocco as shareholders but also traditional non-borrower countries like France, Germany and Belgium. EADB includes the Netherlands and Germany as minority shareholders. Non-borrower shareholders have a substantial ownership stake in Central America's CABEI and a

[8] For a comparative overview of MDB governance and voting power, see Ray (2021).

smaller share in CAF; however, these are not traditional major powers but rather countries like South Korea, Taiwan (Republic of China), Argentina and Spain. Six of the MDBs[9] by statute reserve at least majority voting authority for regional and/or founding members.

Figure 1 Shareholding structure of borrower-led MDBs (2021)



Source: MDB 2021 financial statements

Despite this dominance by borrower member governments, the distribution of governance power is diverse across the 10 MDBs. Most have a relatively balanced shareholding with no dominant shareholder. In EBID and EDB, one country is clearly dominant (Nigeria and Russia respectively).[10] FONPLATA is the only MDB considered here where members share equal voting power due to 'one country, one vote' decision-making rules. This governance variation across borrower-led MDBs is likely to have important operational ramifications, a topic not explored here but worth further investigation.

2.2 Financial and operational characteristics of borrower-led MDBs

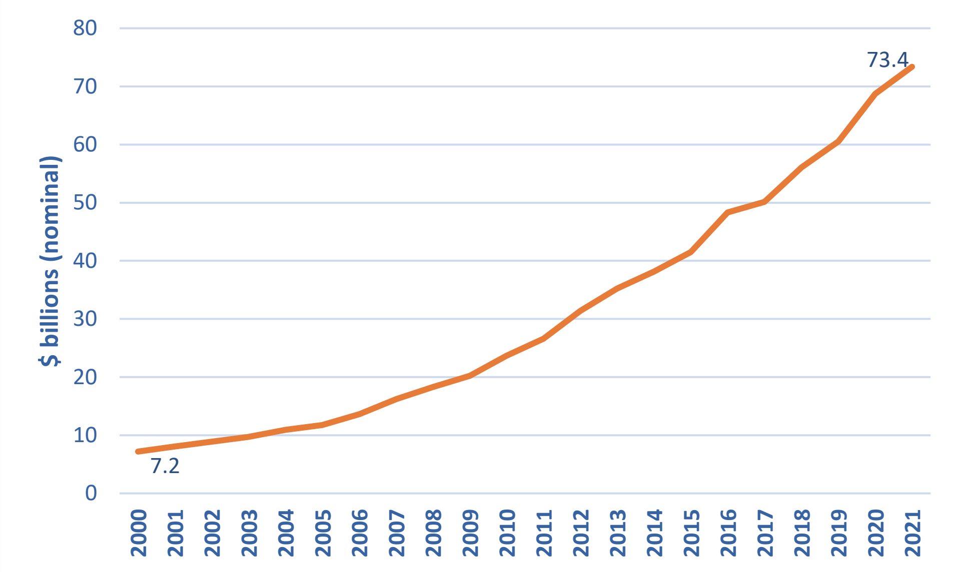
Borrower-led MDBs have posted impressive growth in the past two decades. Taken collectively, the outstanding loan portfolios of the 10 borrower-led MDBs reviewed here grew from $7.2 billion to $73.4 billion between 2000 and 2021 (Figure 2). In absolute terms, this is still well below the loan portfolio of just the main lending wing of the World Bank, but it represents a 920% increase over two decades compared to 83% for the World Bank. Growth has been led in particular by CAF, CABEI, Afreximbank, TDB and BOAD. BSTDB, EDB and FONPLATA have grown more modestly, while EBID and

[9] CABEI, BOAD, BSTDB, EADB, EBID and FONPLATA.

[10] Although not examined in this paper, IsDB is similar, with Saudi Arabia the dominant shareholder.

EADB remain quite small. See Appendix Figure 6 and Figure 7 for the trajectory of individual MDBs.

Figure 2 Outstanding loan portfolio growth of borrower-led MDBs



Source: MDB annual reports and financial statements, 2000–2021

The key factor explaining the change in fortunes for this group of MDBs is their steadily improving ability to access low-cost funding. MDBs need to be able to lend for development projects at terms that are better than the borrower can easily get from other sources. For the major MDBs, this is not difficult as they have a AAA rating and can issue bonds on international capital markets at very low yields. Accessing low-cost funding is more difficult for borrower-led MDBs, since they do not have the backing of wealthy governments and are viewed as risky by bond market investors.

In 1993, CAF was the first borrower-led MDB to receive a bond rating and issue a bond in the US market. Other borrower-led MDBs have followed suit. Although bond ratings are still below the AAA, they have improved steadily and are in eight out of 10 cases above the crucial ‘investment grade’ rating level (Table 2). This has led to an upswing in bond market access. For example, CABEI borrowed 83% of its resources from commercial banks in 1996, but by June 2022 66% of borrowing came from bond issues in 14 currencies. This has brought the cost of funding down and reduced dependence on credit lines from development or export agencies, which are uncertain and come with strings attached. See Appendix Figure 8 for a more detailed trajectory of borrower-led MDB bond ratings.

Table 2 Bond ratings of borrower-led MDBs

	Year first rated	Rating as of Dec. 2021	Investment grade
CAF	1993	A+/Aa3	Since 1993
CABEI	2002	AA/Aa3	Since 2002
BSTDB	2006	A/A2	Since 2006
EDB	2006	BBB/Baa1	Since 2006
EADB	2006	Baa3	Since 2015
TDB	2008	Baa3	Since 2017
Afrexim	2009	Baa1	Since 2010
BOAD	2015	Baa1	Since 2015
FONPLATA	2016	A	Since 2016
EBID	2018	B2	No

Source: Standard and Poor's (S&P) and Moody's press releases and rating reports

Despite this improvement, funding costs remain much higher than AAA-rated legacy MDBs. Borrower-led MDBs also face the same cyclical swings in access to external financial flows (driven by the global interest rate environment) as borrower countries themselves. Access to lower-cost funding therefore remains a challenge. The loan charges from these MDBs are higher and come with shorter repayment periods compared to the legacy MDBs. As a result, these MDBs face greater difficulties lending directly to governments, which can tap other official or commercial financing at terms that are competitive with borrower-led MDBs. Hence, many of these MDBs have tended to focus on lending to private sector borrowers, which have more restricted and more expensive access to funding compared to governments.

Another result is that borrower-led MDBs have much leaner administrative staffing compared to legacy MDBs to keep costs down and reduce loan charges to customers. With much fewer staff, these MDBs offer minimal technical assistance or expertise, which adds value to the financing of the legacy MDBs. BSTDB's strategy (BSTDB, 2018: 19) highlights this tension explicitly, saying that it needs 'to contain the growth in administrative expenses that result from a shift to more complex operations, higher levels of highly trained and experienced staff, as well as a larger presence in the field'. It also means that loan approval and disbursement tend to be streamlined compared to the highly bureaucratic legacy MDBs (see, for example, Chakrabarti and Humphrey, 2022), which is attractive to borrowers but can come at the cost of the quality control and developmental impact.

2.3 Summing up: the trade-offs of borrower-led MDBs

For a group of like-minded EMDEs, creating an MDB on their own is an attractive proposition. It allows them to set up a truly cooperative development institution which they control, without the external impositions from wealthy donor nations that these countries often object to at the legacy MDBs. This governance profile has directly shaped how these MDBs operate and, in the end, their developmental impact.

The immediate causal channel is access to funding. Their ownership profile makes them appear less creditworthy to lenders and rating agencies. This increases the cost of funding and, in turn, tends to make their loans more expensive, with shorter repayment periods compared to the legacy MDBs.[11] For example, EDB (2018: 20) highlights the need for loan pricing to be 'competitive relative to those offered by other MDBs and certain national financial institutions' for the Bank to be effective. Due to the fiscal limitations of EMDE governments, these MDBs also tend to have modest share capital, which means their operational capacity is restricted.

These financial challenges affect demand for loans as well as the kind of projects these MDBs can support. They also incentivise membership expansion to bring in fresh capital, strengthen policy importance and reduce loan portfolio concentration.[12] As noted in CABEI's 2020–2024 strategy (2020: 17), new members can 'improve the terms of financing, increase the credit capacity of the institution, provide new capital and improve credit rating'. Financial pressures push these MDBs to seek out non-market sources of funding such as concessional resources from other official agencies, export banks of non-borrower countries and international climate funds. Lean administrations are also essential to keep loan costs down, but this limits the ability of borrower-led MDBs to build technical expertise and offer value-added support with their financing.

On the other hand, control by borrower countries brings a number of benefits attractive to recipients of financing. These MDBs intimately understand the realities of their EMDE members and have close relations with member governments. 'Country ownership' is embedded in their DNA: they align with and respond to government needs, and they are not inclined to impose their own vision for development in ways that legacy MDBs at times do. They tend to be fast, unbureaucratic and flexible in responding to evolving circumstances and recipient priorities. More broadly, borrower-led MDBs are well-adapted to changing geopolitical circumstances, providing a less hierarchical forum for EMDEs to develop relationships and work on practical problems with one another.

[11] Lending costs compared across borrower-led MDBs and compared to legacy MDBs will be explored in more detail in the second paper in this research project.
[12] Policy importance and loan portfolio concentration risk are positive and negative (respectively) factors in bond rating methodologies. See Moody's (2020) and S&P (2021).

3 BSTDB: supporting post-conflict recovery in the Black Sea region

The ongoing conflict in Ukraine has had a devastating impact on several countries surrounding the Black Sea. The most immediate concern is the humanitarian crisis in Ukraine itself and finding a path to halt the bloodshed and physical destruction. But, as with the post-war planning that started at Bretton Woods in 1944, policy-makers must now begin considering options for when the conflict ends.

The challenges will be multiple and daunting. Shattered basic infrastructure will need to be reconstructed in Ukraine and the economic life of the entire Black Sea region will need substantial financial and technical support to get back on its feet. The conflict has disrupted trade patterns, supply chains, financial flows and the movement of people. It is in the interest of the international community that the region recovers as quickly as possible to contain the scarring impacts and to reduce the chances of further armed conflict. This will require substantial coordinated support.

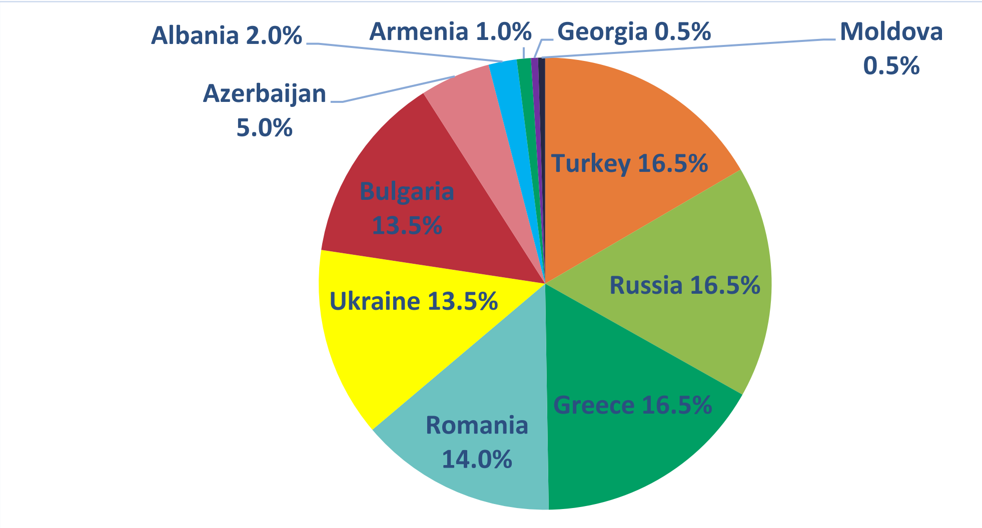
BSTDB can play an important role in this effort. Although modest in size, its loan portfolio grew rapidly in recent years through the end of 2021, its bond rating steadily improved, and it strengthened its engagement with external bilateral and multilateral institutions. BSTDB has a firmly regional mandate, and as a result it has been able to focus on supporting regional economic development and avoiding political entanglements. It is a trusted partner of all the countries in the region, including both Russia and Ukraine.

Institutions like the World Bank, the IMF, the European Bank for Reconstruction and Development and the EIB have much greater financial and technical capacity than BSTDB. These institutions, along with major donor nations, will lead the bulk of reconstruction and economic reactivation efforts. BSTDB can complement other actors by focusing on its areas of expertise and leveraging close relations with governments and private sector actors in the region. It can be even more effective if other MDBs and donors actively involve BSTDB in the post-conflict efforts, channel development resources through BSTDB and give it technical support.

3.1 BSTDB overview

BSTDB was founded in 1997 and is owned by 11 governments of the Black Sea region (Figure 3). Shareholding is relatively balanced among different member countries, in particular among the six largest shareholders, meaning that no single country has sufficient voting power to dominate decision-making. BSTDB has grown rapidly in the past decade. The outstanding loan portfolio nearly quadrupled from €663 million in 2010 to €2.37 billion in 2021, while annual loan approvals rose from €197 million to €820 million over the same period. To support this expansion, member governments have kept BSTDB well capitalised, injecting fresh capital in 2008 and agreeing to another capital increase in 2021 (Moody's, 2022a).

Figure 3 BSTDB shareholding (2021)



Source: BSTDB (2022)

As its name implies, BSTDB splits its lending operations between project lending and trade finance. Trade finance aligns with BSTDB's mandate of promoting regional economic integration and has the added advantage of using relatively short-term loans at near-commercial terms. This helped BSTDB build up a well-performing loan portfolio in its earlier years. More recently, BSTDB has focused on growing its portfolio of longer-term project loans with higher developmental additionality. As of 2021, less than 15% of BSTDB's outstanding loans were for trade finance (BSTDB 2022).

BSTDB lends predominantly to private sector borrowers (76% of the outstanding portfolio in 2021), especially medium-sized enterprises and project finance deals. These borrowers tend to be overlooked by the major MDBs and development finance institutions (DFIs) due to their modest size, but they have difficulties accessing commercial financing at reasonable terms. BSTDB works in a variety of different sectors, including industry and manufacturing (35% of the portfolio), utilities and the banking sector (20% each), consumer goods (13%), health (5%) and energy (2%) (ibid.).

BSTDB has the strategic goals of expanding sustainable infrastructure financing and lending to larger public sector projects (BSTDB, 2021). The Bank approved its first Climate Change Strategy in March 2021 and aims to increase its share of climate-positive operations to 30% of the portfolio. The reality of BSTDB's borrower-led governance means that it remains strongly responsive to demand from borrower country priorities, and as such it is not able to move as aggressively towards climate objectives as the major MDBs.

More reliable access to low-cost, long-term financing is a critical strategic objective for BSTDB. It first received a bond rating in 2004, and steadily improved its rating to A2 (Moody's) and A (S&P) by 2021, supported by a strong loan repayment performance (non-performing loans around 2% over last several years) and high capitalisation. It began issuing bonds on international capital markets in 2012 and as of 2022 had outstanding bonds in 11 different currencies totaling nearly $2 billion (BSTDB, 2022). BSTDB has below-market credit lines totaling over $400 million from other MDBs and official agencies, including EIB, Germany's KfW, the Austrian Development Bank, the China Ex-Im Bank, the Korea Development Bank and NDB.

3.2 Crisis and retrenchment

The onset of armed conflict in Ukraine in February 2022 has severely impacted BSTDB's current situation and medium-term plans. Russia and Ukraine combine for about 30% of the Bank's outstanding loan portfolio at the start of the year, and the economic prospects of those two countries as well as the wider region have radically changed, impacting the current portfolio as well as demand for new projects. Moody's and S&P both downgraded BSTDB's bond rating by one notch in spring 2022 and have the Bank on a negative outlook (S&P, 2022a; Moody's, 2022a).

Despite the difficult situation, BSTDB's loan portfolio continues to perform reasonably well. All Russian borrowers have attempted to remain current on their loans, although EU sanctions have complicated payment transfers to BSTDB's headquarters in Greece. The majority of Ukrainian projects were still current at end-2022, although some – including a major solar plant co-financed with the European Bank for Reconstruction and Development near Kherson – have been damaged and may be written off. Accounting rules have forced BSTDB to substantially increase loan provisioning, which reduces capital available for future loans.

BSTDB remains well capitalised and will receive more capital as part of an increase agreed in 2021. Shareholders are due to pay in over eight years starting in 2023. Both Russia and Ukraine have indicated that they intend to contribute as planned, although sanctions could make this difficult for Russia, at least temporarily. Regardless, much higher loan provisions, greater risk perceptions and uncertain prospects for a lasting political solution to the conflict have led BSTDB to retrench and consolidate. Commitments are projected to decline from roughly €800–900 million annually in recent years to around €130 million in 2023 before slowly rebounding to €350 million in 2024.[13]

It is in the interest of the international community to support BSTDB through the current crisis such that it can play a role in the reconstruction of Ukraine and the economic reactivation of the Black Sea region. BSTDB has strong links with medium-sized businesses in a variety of sectors, and these will be crucial to job creation. New patterns of regional trade are evolving due to shifting geopolitical relations, and the Bank is already seeking to facilitate these new channels.[14] BSTDB is also seeking to increase financing to sustainable infrastructure in line with international climate goals, such as an ongoing guarantee scheme to back independent renewable energy producers supplying grid power in Greece.

[13] Personal communication with BSTDB staff.
[14] One example is a current project where BSTDB is helping a Ukrainian firm re-orientate exports via Constanta, Romania, to Europe, a trade link that has historically been underdeveloped but is likely to take on new importance with former Ukrainian trade routes to the north now closed off.

4 TDB: a channel for new investors into Africa

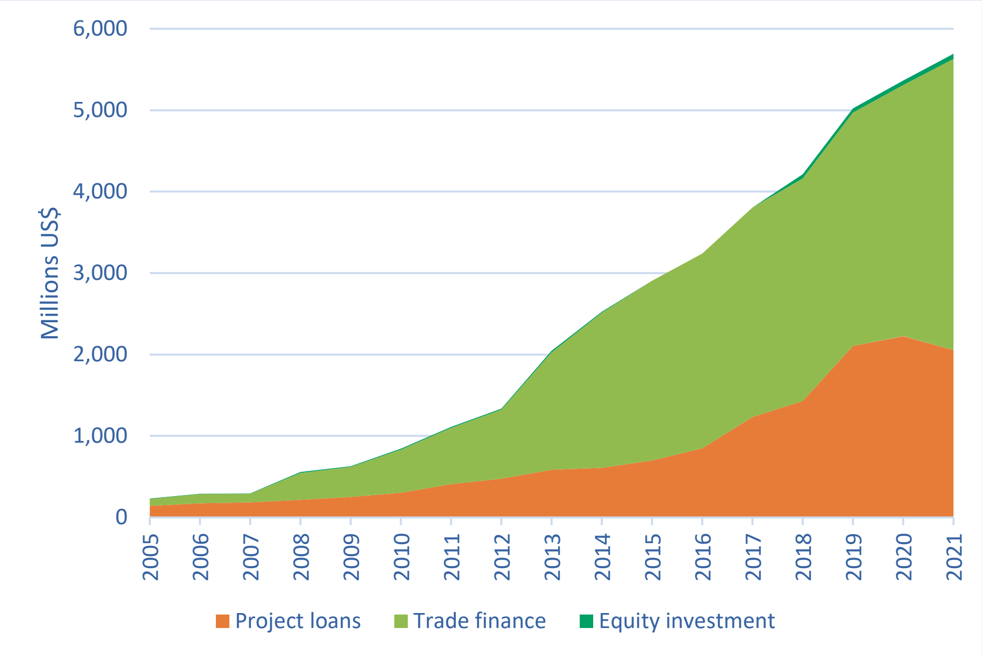
TDB is another rapidly growing borrower-led MDB. Based in eastern and southern Africa, TDB was founded in 1985 and originally named PTA Bank due to its link to the Preferential Trade Agreement of Eastern and Southern Africa (1981). TDB remained a small-scale MDB in its early years, before undergoing a series of internal reforms beginning in 2000 that put it on a more dynamic growth path (Humphrey, 2019).

TDB has 25 sovereign members as of June 2022, of which 23 are African nations (the most recent being Ghana in 2022), along with the AfDB as a long-time shareholder. TDB has 18 non-sovereign institutional shareholders with B class shares. According to TDB statutes, no shareholder can have more than 15% total voting (A and B shares combined). Shareholding is balanced, with nine countries having between 6% and 9% of holdings, the largest being Ethiopia with 9.5%. China is the largest non-regional shareholder, with 7.1% of total shareholding (A and B shares combined).[15]

TDB's development portfolio grew from $232 million in 2005 to $5.7 billion in 2021 (Figure 4). Trade finance plays a major role in TDB lending, accounting for 63% of the portfolio at end-2021. Unlike BSTDB, TDB has a much larger share of its portfolio dedicated to government loans (62% versus 15% for BSTDB), in part due to the more pressing financing needs of its lower-income member countries compared to BSTDB member countries. In sectoral terms, 25% of the portfolio is trade finance for fertiliser and petrochemical imports by member-country governments. Financial services, infrastructure and agri-business each account for about 20% of the portfolio, with the remainder made up mostly of energy generation and manufacturing.

[15] Belarus joined TDB in its early years, motivated partly out of an interest to promote agro-industrial machinery exports from Belarus to Africa. It has 1.49% of TDB class A shares and has not been an active shareholder. See TDB 2021 Annual Report for full shareholding.

Figure 4 Evolution of TDB loans (2005–2021)



Source: TDB annual financial statements 2005–2021

Due to the riskier and lower-income environment of its member countries, TDB has had to work hard to build a well-performing loan portfolio. The large share of sovereign loans has helped, as governments are on the whole more reliable in repaying loans and have afforded TDB a high degree of 'preferred creditor treatment', as at other MDBs. Non-performing loans have declined from very high levels in the early 2000s (19% in 2005) to 2–3% in recent years. TDB insures or takes collateral on a high share of its loans to further reduce risk and support its credit rating. As of June 2022, 42% of the loan portfolio had some type of risk coverage (TDB 2022a).

TDB was first rated in 2008, with initial ratings below investment grade. Moody's subsequently upgraded TDB to the investment grade level of Baa3, pointing to TDB's strong performance but also the difficult operating environment (Moody's, 2022b). TDB's innovative use of insurance – on loan exposures as well as on its own callable capital – helps support its rating. TDB has issued five Eurobonds on international capital markets, the first in 2010 and most recently in 2021 for $500 million at 4.125% for seven years (TDB, 2021). TDB is active in the international syndicated loans market and has credit lines from, among others, EIB, AfDB, Germany's KfW, the Japanese Bank for International Cooperation, Agence Française de Développement and export agencies of China, India and the US.

Of TDB's 23 regional member countries, 18 currently meet the per-capita income criteria for concessional lending from the World Bank. This shareholder profile creates challenges. Fiscal constraints make it difficult for shareholder governments to adequately capitalise the Bank. Also, the high level of perceived risk in the region and low average weighted rating of member countries (B3, one of the lowest averages of all MDBs rated by Moody's) make it very difficult for TDB to obtain low-cost funding.

In response, TDB has undertaken a number of innovations. This paper describes two:[16] i) opening up TDB's shareholding structure to attract new forms of capital, and ii) structuring the first-ever financing from the World Bank Group to a borrower-led MDB. Both of these innovations have improved TDB's operational capacity and are worth closer study by development policy-makers.

4.1 New share classes to private and institutional investors

Obtaining the shareholder capital needed to expand operations is a frequent challenge for borrower-led MDBs, one that TDB faces more than most due to the low revenue and high spending needs facing many member governments. To overcome this obstacle, TDB reformed its statutes in 2013 to create class B shares for non-sovereign institutional investors. Out of $732 million in paid-in capital as of June 2022, $262 million (36%) was owned by 18 institutional shareholders (TDB 2022a). Most are regional insurance companies or pension funds, while others include the Organization of the Petroleum Exporting Countries (OPEC) fund, Denmark's Investment Fund for Developing Countries and the Arab Bank for Economic Development in Africa.

Unlike shareholders at most other MDBs, these class B shareholders earn a return on their shares. By policy, TDB dedicates 75% of net income to reserves, and it can distribute the remainder as dividends. Due to TDB's consistently high return on equity (over 10% since 2014), B shareholders have seen a dividend return of 2–3% per year. Shareholders are permitted to take the dividend in cash or retain it to help TDB grow shareholder equity and hence operational capacity.[17]

In 2022, TDB launched a new class C share geared towards impact investors. The proceeds of dedicated tranches will be ring-fenced for climate-aligned and sustainability-focused investments. One tranche of C shares will be initially offered to institutional investors and is to be locked in for a period of up to 10 years. Another tranche will be opened up to impact investors worldwide in 2023 and is being considered for listing on one or more exchanges, for higher liquidity and easier exit. TDB is also considering launching a hybrid capital instrument.

This innovative shareholding structure to channel new investors into development finance is used by only one other MDB (Afreximbank).

[16] A third innovation worth further exploration is the use of insurance to cover a share of TDB's loan book against non-repayment, and – even more unusually – the insurance of a share of TDB's callable guarantee capital. Both help support TDB's investment grade bond rating from Moody's (Moody's, 2022b).

[17] Personal communication with TDB staff.

The demand for impact investment opportunities is growing rapidly worldwide, and capital shares in an MDB are a new type of asset that offer a higher financial impact than debt (share capital is leveraged by MDBs, whereas debt is just 1:1). The creation of new share classes for non-sovereign investors has considerable potential for other borrower-led MDBs. It would likely face political hurdles at the major MDBs, although new share classes do not have to come with voting rights (TDB's C shares do not) so would not necessarily have governance implications.

At the same time, this technique has trade-offs. Paying a dividend to shareholders requires return on equity, which has implications for the pricing of MDB loans, the kinds of loan an MDB makes and the ability of an MDB to invest in specialised staff. All of this could pressure an MDB to act more like a commercial bank and move away from development impact. In the case of TDB this is less problematic, as it operates in trade and private sector financing and in the commercial tranches of development loans. Also, the geography where TDB operates is characterised by high demand for financing in a high interest rate environment. As such, TDB is able to generate net income while still investing in economic development projects. Other MDBs should carefully consider whether this trade-off would make sense for their operating context and mandate.

4.2 On-lending facility from the World Bank Group

Most borrower-led MDBs, including TDB, utilise credit facilities from larger MDBs or bilateral development agencies to help bring down their overall cost of funding, reducing the terms of their own loans to borrowers. In the past, the World Bank – the most high-profile MDB and a lead institution in international development – has not channelled financing through borrower-led MDBs. In 2020, however, two divisions of the World Bank Group provided a major package of financing to TDB in three components (TDB 2020):

- A $400 million loan from the World Bank's International Development Association (IDA) window for lower-income countries,[18] of which $75 million is for Covid-19 recovery and $325 million for sustainable infrastructure projects.
- A $15 million loan from IDA at concessional terms for TDB internal use (including project preparation).
- A €359 million guarantee facility from the Multilateral Investment Guarantee Agency (MIGA) to bring down the costs of a loan to TDB by a syndicate of commercial banks, of which €50 million is for Covid-19 recovery and the remainder unearmarked trade finance (MIGA 2020).

[18] Although provided by IDA, the financial terms are the same as those offered by the World Bank's lending window for middle-income countries (International Bank for Reconstruction and Development).

The initial trigger to create the World Bank facility was MIGA's interest in minimising trade disruptions across Africa in the Covid-19 crisis, particularly for basic imports and food security. MIGA's involvement gave added impetus for IDA to become involved, with a focus on supporting sustainable infrastructure. World Bank engagement helped bring down TDB funding costs and extend repayment – 20 years for the IDA loan and seven years for the MIGA-guaranteed trade finance syndication. This has given TDB greater flexibility in on-lending. Infrastructure projects in particular require longer maturity loans due to lengthy construction processes, and the IDA resources give TDB a pool of long-dated resources dedicated to infrastructure.

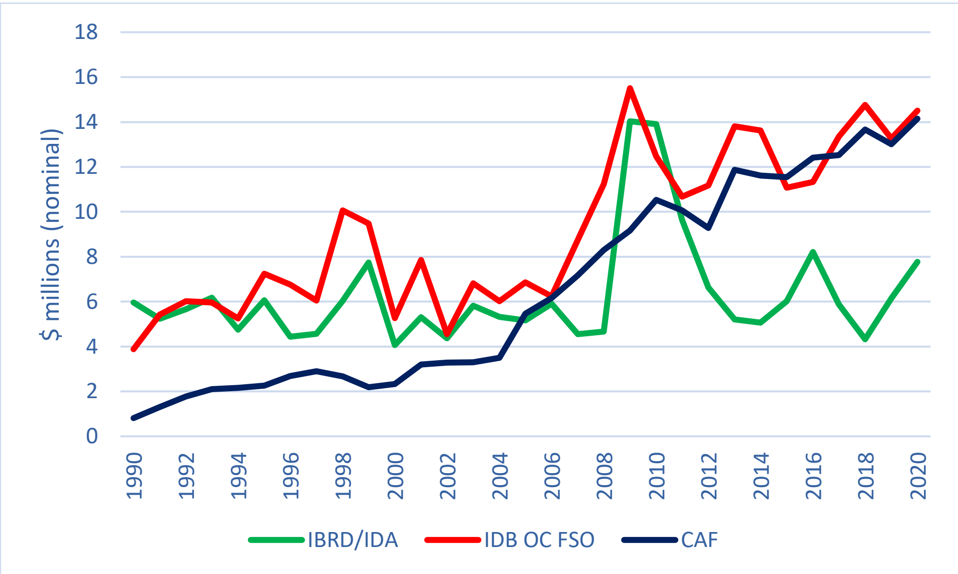
Working with the World Bank is highly beneficial for TDB, but does poses some challenges. For example, the IDA infrastructure facility specifies that TDB can only on-lend to private sector project developers (World Bank, 2020). However, the majority of infrastructure in lower-income African countries is financed by the public sector, due to risk perceptions among private investors. The World Bank also requires a detailed and lengthy process for project vetting, including environmental and social safeguards that are beyond what TDB would normally require. Both of these factors could impact demand.

More broadly, the operation is a strong signal that the World Bank considers TDB to be developmentally relevant and financially reliable, which can have an important impact on how TDB is perceived by bond markets, regional borrowers and the international development community. It can also serve as a potential model for future World Bank engagement with other borrower-led MDBs, leveraging their local knowledge and relationships and helping them strengthen their financial and technical capacity.

5 CAF: a borrower-led MDB taking the next step

Latin America's CAF was founded in 1970 by six countries in the Andean region, and in its first two decades struggled to find a useful role. Starting in 1990, CAF embarked on an impressive growth trajectory in terms of membership, annual lending volumes, financial strength and operational sophistication. By 2020, CAF's annual lending was similar to that of the IDB and roughly double that of the World Bank in Latin America (Figure 5). CAF shows what an MDB can achieve without the membership of wealthy shareholder government involvement, and it has served as a model to other borrower-led MDBs.

Figure 5 CAF annual lending commitments (1990–2020)



Note: OC = Ordinary capital (IDB's non-concessional lending window); FSO = Fund for Special Operations (IDB's concessional lending window, which closed in 2016).

Source: CAF, IBRD and IDB annual reports, 1990–2020

The story of CAF's rise has been told elsewhere (Humphrey, 2022a). Key elements include a clear-eyed understanding of the importance of accessing bond market financing, internal organisational reforms, responsiveness to client needs and non-bureaucratic loan approval and disbursement procedures, among others. CAF has a nearly unblemished record of loan repayment by member government borrowers,[19] even in the worst crisis years of the 1980s and 1990s, which has underpinned its financial stability (non-performing loans of 0.3–0.5% of the portfolio over the last decade) and its steadily rising bond rating (AA- by S&P and Aa3 by Moody's in 2022). As of 2022, CAF had $20 billion in bonds outstanding in 15 different currencies (CAF, 2022a).

Membership expansion has been a critical component of CAF's strategy. CAF was founded with six Andean countries, although Chile quickly dropped out in the early 1970s. Now it has 20 sovereign member countries, including all the major economies of Latin America, English-speaking Caribbean nations such as Barbados and Trinidad and Tobago, and Spain and Portugal from Europe. Chile also rejoined CAF. This expansion has allowed CAF to reduce the concentration of its loan portfolio – a major limiting factor facing smaller MDBs in the eyes of credit rating agencies – and expand share capital and hence lending capacity.

CAF's access to low-cost bond market funding, combined with low administrative costs and a streamlined loan administration bureaucracy, has made it an attractive source of development finance to regional governments. A large majority (93% in 2022) of CAF's outstanding loan portfolio is sovereign guaranteed, of which a substantial share is to sub-national governments (provinces and municipalities) and state-owned enterprises. CAF has long financed basic infrastructure, particularly transport, energy and water, but in recent years has increased lending for education and health as well as budget support lending (unusual among borrower-led MDBs).

5.1 Member governments investing in CAF to step up

Member governments have supported CAF by prioritising repayment even in crisis situations and through regular shareholder capital increases. CAF has received 10 capital increases over its history, the most recent a $7 billion paid-in commitment approved in December 2021 (CAF 2022) – nearly as much as the World Bank's 2018 capital increase, but by only 20 member countries instead of 189 for the World Bank. It has continued to attract new shareholders, with El Salvador joining in December 2021. Four class B shareholder countries are now in the process of becoming class A members (Chile, Costa Rica, Dominican Republic and Mexico) with full voting power and greater borrowing eligibility.

Growing membership and increased capital strengthens CAF's ability to serve as a useful development financier, not least by supporting its bond rating – the recent capital increase was a key reason for S&P to upgrade CAF from A+ to AA- (S&P, 2022b). Concerted efforts by

[19] In 2017, Venezuela became the first member government in danger of falling into arrears to CAF. In response, CAF created a mechanism to reduce Venezuela's share capital as a way for the government to remain current, thus technically avoiding what would have been CAF's first sovereign default. This approach has been broadly accepted by rating agencies (see, for example, S&P (2022b).

CAF management to improve the institution in the past three decades have fed into greater shareholder support, which in turn makes CAF even more attractive.

As a result of this virtuous circle, CAF is now in a solid position but also at a hinge point in its trajectory. It has moved well beyond being a sub-regional MDB, hence its efforts to rebrand itself as the ‘Development Bank of Latin America’ rather than its original name of *Corporación Andina de Fomento* (‘Andean Development Corporation’ in English). It is well established in bond markets and has strong access to low-cost funding, although it must continue to protect its bond rating and is unlikely to achieve a AAA rating without accepting major non-borrower members. Government and private sector borrowers in Latin America can access financing from commercial and impact investors, meaning CAF must step up its game to ensure continued relevance as a development financier.

5.2 Responding to the Covid-19 emergency

The Covid-19 crisis hit Latin America badly, with regional gross domestic product (GDP) plunging by 7.1% in 2020 (IMF, 2022) and a reversal in progress in poverty and other social indicators (UN ECLAC, 2022). World Bank and IDB lending to the region did not dramatically increase in the early phase of the crisis compared to the previous years, in contrast to the global financial crisis a decade previously (Humphrey and Prizzon, 2021). Fast-disbursing budget support lending – most useful for governments to face a sudden crisis – was not forthcoming in substantial volumes, and the policy conditionality linked to it was perceived to be overly cumbersome (Landers and Aboneaaj, 2021).

Despite its restricted financial capacity, CAF was quick to respond to regional governments in need, with a stepped-up volume of fast-disbursing resources. This included budget support loans and flexible credit lines for governments to tap into as the crisis and their fiscal needs evolved. CAF created emergency credit line facilities for overall crisis recovery ($4.1 billion), a regional epidemic credit line for health systems ($300 million), a financial credit line for national development banks ($1.6 billion) and liquidity facilities for health care systems ($500 million) and public utilities ($1.2 billion) (CAF 2022). Government lending approvals rose by one-third ($6.7 billion in 2019 to $9.3 billion in 2020) and disbursements to governments doubled ($3.2 billion in 2019 to $6 billion in 2020) (CAF 2020 Annual Report).

This episode demonstrates how borrower-led MDBs can flexibly and quickly react to support their member governments. The legacy MDBs were slower to react at scale and were often tied down with restrictions on how resources could be used. In the initial months of the Covid-19 crisis, for example, major donors pushed the legacy MDBs to support low-income countries – a commendable aim, but one that left the badly affected but middle-income region of Latin America as a lower priority. CAF, by contrast, immediately reprogrammed its financial plans to provide as much support as quickly as possible to member countries, even though the fast-disbursing budget support loans posed a challenge to its capital adequacy. CAF's decisive support was a key factor in governments agreeing to the largest capital increase in CAF history in 2021.

5.3 Becoming a 'green' MDB

CAF has historically offered substantial financing for basic infrastructure, and it has in the past been criticised as the 'highway bank' with limited concern for environmental and sustainability considerations (BIC, 2008). In recent years, however, CAF has moved steadily towards a greater focus on sustainability and climate alignment. CAF is an accredited implementing agency of the Adaptation Fund (2014), the Global Environment Facility (2015) and the Green Climate Fund (2015) and it has undertaken environmentally oriented projects with bilateral donors. At the United Nations Climate Change Conference (COP 26) in Glasgow in 2021, CAF announced its intention to allocate $25 billion to green projects up to 2026 and increase the share of green projects from 24% to 40% of its portfolio (CAF, 2021).

How these laudable goals are defined and operationalised remains to be seen. As a borrower-led MDB, CAF must remain highly responsive to its borrowing members and cannot impose policy priorities on recipients in the way that the legacy MDBs – following the directives of major non-borrower shareholders – are at times prone to do. CAF must find a way to balance sustainability objectives with borrower demand. But with regional governments themselves increasingly concerned with sustainability, demand for financing in areas such as renewable energy, public urban transport networks and water systems management is growing.

A key concern for non-governmental organisations (NGOs), as well as some potential official donors, is CAF's environmental and social safeguard policies. As a borrower-led MDB, CAF's instinct has been to defer to the laws and regulations of borrower countries, and until the early 2000s it had only a three-page safeguard policy with minimal requirements (BIC, n.d.). CAF implemented a revised safeguard policy in 2016 (CAF, 2016), which an independent review found to be substantially strengthened, although 'there is still deference to local rules and methods' (Conectas, 2018: 49; see also Gallagher and Yuan, 2017). Due to its governance, CAF must seek a middle ground: establishing meaningful environmental and social standards while not imposing top-down external rules to which borrowers might object.

5.4 Diversifying funding options

Reliable access to low-cost, long-term funding is a top priority and constant concern for CAF. Its relatively high bond rating gives it strong access to global capital markets, but crises in member countries can have a major impact, as the recent turmoil in Venezuela has shown. As it seeks to further improve its credit rating, CAF has undertaken other strategies to bolster funding.

CAF is the first borrower-led MDB to issue green and social bonds, the proceeds of which are earmarked for projects meeting green and social criteria (CAF 2019 and 2020). Institutional investors are major bond buyers and have increasing mandates to invest a share of their resources in sustainable assets, which has stimulated the growth of the green and social bond markets. Since 2018, CAF has issued four green bonds for a total of just under $2 billion (CAF, 2022). During the Covid-19 pandemic, CAF issued three social bonds in 2020 (one in euro and two in Japanese yen) for roughly $800 million equivalent (ibid.). Both programmes have been deemed credible by an independent evaluation agency (Sustainalytics, 2019 and 2020).

CAF has found creative techniques to mobilise third-party resources to bring down overall funding costs, including official co-financing from other development agencies, loan syndications with private investors and even loan sales to commercial banks. Official co-financing has averaged about $250 million annually over the last several years, including from France's *Agence Française de Développement*, the Green Climate Fund and the Global Environment Facility. Loan syndications and loan sales to private investors have averaged roughly $200 million per year. While these amounts are relatively modest compared to the resources mobilised by the major MDBs, they are a sign of confidence of official and commercial financiers in CAF's reliability.

A final point to mention is that, unusually among MDBs, CAF accepts deposits as a substantial share of its borrowing. These are from regional institutional investors, mostly the central banks of member governments who see a use in depositing a share of their reserves in an institution that they own and which can invest the resources in their country's development. Deposits provide a useful addition to CAF's overall funding mix and are another sign of the confidence regional investors have in CAF. At end-2021, deposits amounted to about $4 billion, or 12% of total liabilities (CAF 2022).

6 Conclusions and policy implications

In the face of near-term crises coupled with long-term global development challenges, it is essential to maximise all potential sources of finance and cooperation. While the World Bank and major regional MDBs are central to international development discussions, borrower-led MDBs are often overlooked.

These institutions face obstacles to providing useful development services, notably higher funding costs and relatively limited value-added knowledge services. But they have a number of strengths, in particular an operational style much more in line with the growing trend of countries taking greater charge of their own development agenda. Their governance arrangements give them a higher degree of operational flexibility, allowing them to innovate and respond to changing circumstances in ways that are more difficult for the legacy MDBs.

Responsiveness to the needs and priorities of their borrowers is built into their DNA, yet they also seek to balance that with internationally agreed development targets. All of the 10 borrower-led MDBs reviewed here have stated in policy documents and annual reports that they intend to ramp up support for sustainable infrastructure, climate change adaptation and social programmes. They have also responded to major crises such as the Covid-19 pandemic and the ongoing Ukraine conflict. Doing so is not simple due to the financial and capacity constraints these MDBs face.

Bilateral aid agencies of high-income countries, legacy MDBs, international philanthropies and impact-oriented investors can help these MDBs play a more significant role in global development. The most direct and obvious support is financial. Borrower-led MDBs have improving but still restricted access to international capital markets. This may become more problematic in the looming higher interest rate environment and as global investors retreat from emerging markets. Respected development agencies can help improve the terms of funding for borrower-led MDBs, which in turn greatly increases their relevance as a development financier. Borrower-led MDBs can also benefit from technical assistance to strengthen risk management, environmental and social policies, private investor engagement and more.

For external partners, it is imperative to strike the right balance between positive influence and top-down imposition. It can be tempting for external agencies to seek to impose strict requirements on project funding, loan processing and reporting requirements and even MDB policies and management. The reason why borrower-led MDBs are a potentially useful complement to the international development finance ecosystem is precisely that they are controlled by borrower member countries. Using external financial support to force these MDBs to operate like the legacy MDBs could undermine their strengths.

6.1 Credit lines

Low-interest, long-maturity credit lines are the easiest technique for external agencies to support borrower-led MDBs. Numerous multilateral and bilateral development agencies as well as export finance agencies currently offer credit lines of differing financial terms to borrower-led MDBs. Such credit lines are most common for long-term development purposes, although they can also be useful for shorter-term crisis response packages to take advantage of an MDB's local deployment capacity.

Credit lines are most useful at a relatively large size ($50 million and up), although this depends on the MDB's own needs. Sub-market interest rates are obviously a very important factor, but just as important are long repayment maturities and the potential for renewal after expiration to improve the reliability of MDB finances.

Earmarking is invariably a topic of much negotiation. Export agencies require the purchase of goods and services from the lender country, which can be a serious drawback depending on the type of project and the quality of the available exporting firms. For development agencies, it makes sense to designate broad areas with clear results criteria, but to leave a degree of flexibility to the MDB itself on how to best achieve the desired results to take advantage of its deep client knowledge and flexible operational approach.

Other MDBs and bilateral agencies are the likeliest sources of credit lines to borrower-led MDBs. Philanthropic institutions and impact investment firms could also consider providing credit lines, but the ticket size may be too high in many cases.

6.2 Co-financing, syndication, loan sales

Co-financing development projects with legacy MDBs or with bilateral DFIs is an excellent deal-by-deal way to support borrower-led MDBs. This can either mean joining a project originated by the borrower-led MDB, or the borrower-led MDB contributing additional resources to a project originated by a legacy MDB or DFI. The latter is easier in practical terms as the larger MDB/DFI would need to follow its own loan processing and safeguard requirements, but the former would be a more meaningful show of support to the borrower-led MDB.

In either case, co-financing offers multiple benefits. In financial terms, it de-risks the MDB's loan portfolio and allows it to contribute to larger projects than it could fund by itself. It is an important signal of credibility by the external partner to the MDB's management and development strategy, improving the perception of reliability by external actors, notably rating agencies. If done well, with joint missions and active engagement between the teams, it can be an important learning experience for borrower-led MDB project staff on structuring and implementing quality development projects.

Syndication and loan sales are useful options for borrower-led MDBs to engage directly with commercial investors. This involves an external investor co-financing a loan originated by the MDB or buying an already performing loan directly off the books of the MDB. Because these MDBs tend to have lower credit ratings, it is not as easy to attract commercial investors compared to the legacy MDBs. The upside, however, is that these loans usually pay a higher interest rate than legacy MDB loans. This can make them an attractive option for impact-oriented investors willing to take higher risks in return for higher financial and developmental returns.

6.3 Risk transfers

Several legacy MDBs have undertaken 'exposure exchanges' to improve the risk profile of their loan portfolios. The first was executed in 2015 with the participation of AfDB, IDB and the World Bank (World Bank, 2015), while the most recent was announced by IDB and the Asian Development Bank in December 2022 (ADB, 2022). These operations transfer the repayment risk on a given set of loans from one MDB to another, and in return the first MDB takes over the repayment risk of a similar set of loans from the other MDB. Hence, the overall risk profile of the portfolio remains unchanged, but the country borrowers are diversified. This reduces the 'concentration penalty' assessed by rating agencies on MDBs, which can be particularly problematic for regional MDBs.

This concentration penalty is a major issue for most borrower-led MDBs, as they lend to a relatively small set of borrowers. Should legacy MDBs undertake exposure exchanges with borrower-led MDBs, operations much smaller than those they have already done could have a substantial positive impact on the credit rating metrics of the borrower-led MDBs. Some logistical difficulties would have to be overcome, including the fact that the bond rating of the borrower-led MDBs would be lower, legal stipulations in loan contracts might be different and governance considerations could arise due to different shareholding composition. But if these obstacles can be overcome, it could open up new ways for legacy MDBs to collaborate with borrower-led MDBs.

Other types of risk transfers are possible with commercial counterparties, particularly those with a higher risk appetite and seeking development impact. One option is a synthetic securitisation, in which private investors take on the repayment risk of a set of MDB loans, for a fee. If the underlying borrower does not repay the MDB, then the investors are committed to doing so. Another option is to buy credit risk insurance from the commercial insurance market to cover the repayment risk of a set of MDB loans. Either of these types of risk transfers can be done on a purely commercial basis, or at a slightly sub-market cost for an 'impact first' arrangement. AfDB has undertaken both types of transactions (see AfDB, 2018; Humphrey, 2022b), while among borrower-led MDBs TDB has been active in using the insurance market to reduce risk.

6.4 Share capital

External partners can take a shareholding stake in the capital structure of some borrower-led MDBs. Most of the 10 MDBs considered in this paper have stipulations limiting the total amount non-borrower shareholders are eligible to have, but they do not prohibit non-borrowers from joining in a minority position. The advantages of joining as a shareholder over other types of financial support are several:

- Capital is the building block of any MDB, and it is in short supply for many borrower-led MDBs, restricting their operational capacity. A small amount of share capital goes a long way.
- Resources contributed as share capital are leveraged several times and continue generating support indefinitely, unlike unleveraged and time-bound loans.
- Shareholders have a voice and vote (although in a minority position), meaning they can attend annual meetings, participate in policy and operational decisions, and contribute to the strategic direction of the MDB.
- The presence of non-borrower shareholders is a major plus in the eyes of credit rating agencies and other external actors, thus supporting the ability of the MDB to access funding, work more with private investors and have more credibility in international development discussions.

A number of borrower-led MDBs target non-borrower members as a key part of their growth strategy, including CABEI, BOAD, EADB, TDB and BSTDB. The optimal result is a higher-rated high-income country (or that country's development agency or DFI) willing to take a relatively small share of capital, as is currently the case with agencies from Germany, the Netherlands, Belgium and Denmark for three MDBs in Africa. Export agencies of China and India are also shareholders in African borrower-led MDBs, although their lower sovereign rating is less helpful to the MDB. Some MDBs prefer to find a legacy MDB willing to join as a shareholder, as AfDB and EIB already are in some MDBs. BSTDB has prioritised this approach, saying in its 2018 strategy that it seeks an MDB 'with a large presence on the global development stage' as a shareholder to give 'a boost to the Bank's credit and financial profiles' (BSTDB, 2018: 23). TDB and Afreximbank have gone a step further, soliciting commercial investors seeking a financial return on their stock. This could be a useful technique for both impact investors as well as large international philanthropic institutions to consider.

6.5 Coordination on the international development agenda

Legacy MDBs and other development actors should systematically involve borrower-led MDBs in discussions on how to tackle global development challenges. This means inviting their representatives to international conferences, incorporating them into panel discussions and workshops and seeking opportunities to work together on areas of relevance to member countries. These MDBs bring new perspectives to the table, deeply informed by low- and middle-income country priorities but also through their engagement with investors and the different approach to development compared to traditional actors. Working with the International Development Finance Club, a respected umbrella organisation to which many borrower-led MDBs belong, is an excellent place to start, as is working more with the Finance in Common network.

Coordination with borrower-led MDBs can be useful in crises and recovery from crises. In extreme situations like armed conflict, pandemics or natural disasters, it is imperative for the international community to work together, avoid duplication and deploy all available channels of support. With their extensive local knowledge and relationship network, adaptability and streamlined operating style, these are excellent institutions to bring together with the larger agencies of the United Nations, legacy MDBs and major donors, as all three case studies in this report have illustrated.

6.6 Recognition in financial regulation

Borrower-led MDBs would benefit from official recognition by the BCBS in its assessment of risk weights. The BCBS framework explicitly names MDBs that have (or had) AAA ratings as a unique asset category with zero risk weights, which is a positive incentive for investors holding bonds from these MDBs (BCBS, 2017). However, BCBS provides no guidance to investors on the risk weighting of borrower-led MDBs, despite the fact that they are also within this unique asset class, as evidenced by the fact that they are rated with the same supranational methodologies used by rating agencies for the legacy MDBs. BCBS can remove uncertainty by incorporating borrower-led MDBs into their risk weighting framework in an appropriate fashion. A group of eight borrower-led MDBs sent a letter to BCBS requesting consideration of this issue in 2020, but as yet BCBS has not responded.

Similarly, the IMF should clarify the preferred creditor status of sovereign loans issued by borrower-led MDBs in sovereign debt restructuring. Preferred creditor status is a critical component of the MDB financial model and important to support credit ratings. Moreover, in recent years sovereigns have in practice continued to treat their borrower-led MDBs as preferred creditors. Sovereign loans from borrower-led MDBs should be formally exempt from debt restructurings, as is already the case for the legacy MDBs. With a number of sovereigns already in or nearing restructuring, this could become an increasingly relevant issue for borrower-led MDBs in the near term.

References

ADB (Asian Development Bank) (2022) ‘ADB, IDB scale up exposure exchange with new $1.5 billion agreement’. News release, 12 December. Manila: ADB.

AfDB (African Development Bank) (2018) ‘African Development Bank and partners’ innovative Room2Run securitization will be a model for global lenders’. News release, 14 October. Abidjan: AfDB.

Attridge, S. and Novak, C. (2022) *An exploration of bilateral development finance institutions’ business models.* ODI Working Paper. London: ODI (www.odi.org/en/publications/an-exploration-of-bilateral-development-finance-institutions-business-models/).

Babb, S. (2009) *Behind the development banks: Washington politics, world poverty and the wealth of nations.* Chicago IL: University of Chicago Press.

Bazbauers, A. and Engel, S. (2021) *The global architecture of multilateral development banks: a system of debt or development?* New York: Routledge.

BCBS (Basel Committee for Banking Supervision) (2017) ‘Basel III: finalising post-crisis reforms’. Basel: BCBS.

BIC (Bank Information Center) (2008) ‘Corporación Andina de Fomento, Guión Básico para la Sociedad Civil’. Washington DC: BIC (https://silo.tips/download/corporacion-andina-de-fomento-caf-guion-basico-para-la-sociedad-civil).

BIC (n.d.) ‘Corporación Andina de Fomento’. Washington DC: BIC (http://archive.bankinformationcenter.org/es/instituciones/caf/).

BSTDB (Black Sea Trade and Development Bank) (2018*) Medium-term strategy and business plan 2019–2022.* Thessaloniki: BSTDB.

BSTDB (2021) *Long-term strategic framework 2021–2030: revitalizing the Bank’s potential.* Thessaloniki: BSTDB.

BSTDB (2022) *Investor presentation.* Thessaloniki: BSTDB.

CABEI (2020) *Estrategia Institucional BCIE 2020–2024.* Tegucigalpa: BCIE.

CAF (2016) *Salvaguardas Ambientales y Sociales*. Caracas: CAF.

CAF (2019) *CAF’s green bond framework*. Caracas: CAF.

CAF (2020) *CAF’s social bond framework*. Caracas: CAF.

CAF (2021) ‘CAF to allocate USD 25 billion over the next five years to promote green growth’. Press release, 8 November. Caracas: CAF.

CAF (2022) *Presentación de Inversionistas*. Caracas: CAF.

Chakrabarti, S. and Humphrey, C. (2022) ‘Rebooting the World Bank’. *Project Syndicate*, 28 November.

Chin, G. (2014) ‘The BRICS-led development bank: purpose and politics beyond the G20’ *Global Policy* 5 (3): 366–373.

Chin, G. (2019) ‘The Asian Infrastructure Investment Bank – new multilateralism: early development, innovation, and future agendas’ *Global Policy* 10 (4): 569–581.

Conectas (2018) *Country systems and environmental and social safeguards in development finance institutions.* Conectas: Sao Paulo.

Delikanli, I., Dimitrov, T. and Agolli, R. (2018) *Multilateral development banks: governance and finance.* London: Palgrave Macmillan.

EDB (Eurasian Development Bank) (2018) *Eurasian Development Bank strategy for the period from 2018 to 2022*. Almaty: EDB.

Gallagher, K. and Yuan, F. (2017) ‘Standardizing sustainable development: a comparison of development banks in the Americas’ *Journal of Environment & Development* 26 (3): 243–271.

He, A. (2016) *China in the international financial system: a study of the NDB and the AIIB*. CIGI Papers 106. Waterloo: Center for International Governance and Innovation.

Humphrey, C. (2019) ''Minilateral' development banks: what the rise of Africa's Trade and Development Bank says about multilateral governance' *Development and Change* 50 (1): 164–190.

Humphrey, C. (2022a) *Financing the future: multilateral development banks in the changing world order of the 21st century*. Oxford: Oxford University Press.

Humphrey, C (2022b) 'AfDB's new Room2Run highlights opportunities and questions about MDB risk transfer'. ODI Insight, 6 December. London: ODI (https://odi.org/en/insights/afdbs-new-room2run-highlights-opportunities-and-questions-about-mdb-risk-transfer/).

Humphrey, C. and Prizzon, A. (2020) 'Scaling up multilateral bank finance for the Covid-19 recovery'. ODI Insight. London: ODI (https://odi.org/en/insights/scaling-up-multilateral-bank-finance-for-the-covid-19-recovery/).

IMF (International Monetary Fund) (2022) *Regional economic outlook: western hemisphere.* Washington DC: IMF.

Institute for Development Studies (2000) *Foresight and policy study of the multilateral development banks*. Sussex: University of Sussex IDS.

IsDB (Islamic Development Bank) (2023) 'Islamic Development Bank Group commits to supporting "climate resilient Pakistan" with US$4.2 billion in financing'. Press release, 9 January. Jeddah: IsDB.

Landers, C. and Aboneaaj, R. (2021) *World Bank budget support in the time of COVID: crisis finance… with strings attached*. Washington DC: Center for Global Development.

MIGA (Multilateral Investment Guarantee Agency) (2020) 'Eastern and Southern African Trade and Development Bank – Non-Honoring of Financial Obligations – Regional Development Bank'. Project brief, 29 June. Washington DC: MIGA (https://www.miga.org/project/eastern-and-southern-african-trade-and-development-bank-non-honoring-financial-0).

Moody's (2020) *Multilateral development banks and other supranational entities methodology*. New York: Moody's.

Moody's (2022a) *Black Sea Trade and Development Bank – Baa1 negative*. New York: Moody's.

Moody's (2022b) *Trade and Development Bank – Baa3 stable*. New York: Moody's.

Ray, R. (2021) 'Who controls multilateral development finance?' *Global Governance* 27 (1): 118–143.

Serrano, O. (2019) 'The new architects: Brazil, China, and innovation in multilateral development lending' *Public Administration and Development* 39 (4–5): 203–214.

S&P (Standard and Poor's) (2021) *Supranationals special edition.* New York: S&P.

S&P (2022a) *Black Sea Trade and Development Bank 'A-/A-2' ratings affirmed; outlook remains negative.* New York: S&P.

S&P (2022b) *Corporación Andina de Fomento upgraded To 'AA-/A-1+' on strengthened capital position; outlook positive.* New York: S&P.

Sustainalytics (2019) *Second-party opinion: CAF's green bond framework.* New York: Sustainalytics.

Sustainalytics (2020) *Second-party opinion: CAF's social bond framework.* New York: Sustainalytics.

TDB (Trade and Development Bank) (2020) "World Bank Extends to TDB a Debut USD 415 million Long-term Infrastructure Finance Facility—the First of its Kind." Press release, 1 July. Nairobi: TDB.

TDB (2021) 'TDB issues a historic 7-year global Eurobond'. Press release, 24 June (https://www.tdbgroup.org/tdb-issues-a-historic-7-year-global-eurobond/).

TDB (2022a) *Interim financial statement.* Nairobi: TDB.

TDB (2022b) *Class C green+ shares for impact investors.* Nairobi: TDB.

UN ECLAC (United Nations Economic Commission for Latin America and the Caribbean) (2022) *The sociodemographic impacts of the COVID-19 pandemic in Latin America and the Caribbean.* Santiago: UN ECLAC.

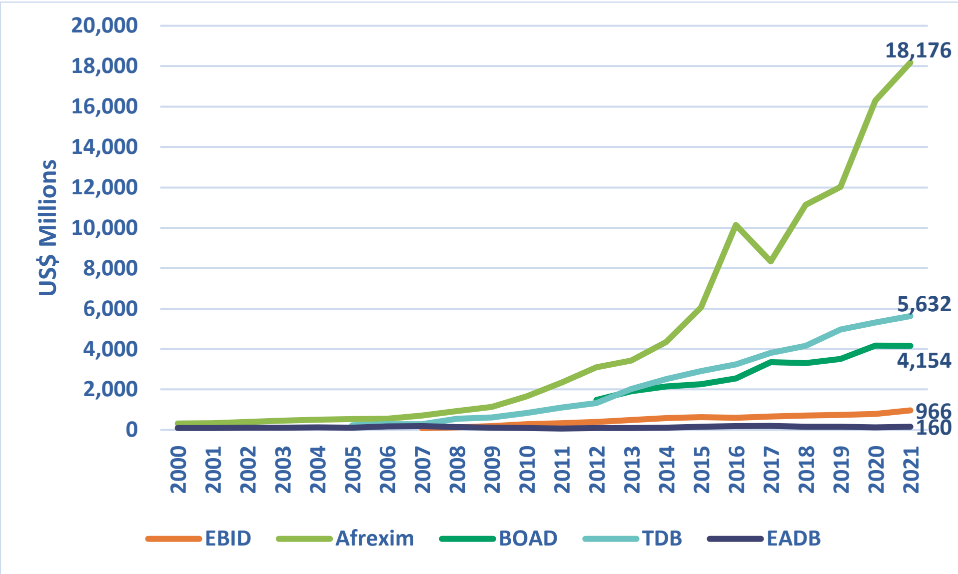
Wang, H. (2019) ‘The New Development Bank and the Asian Infrastructure Investment Bank: China’s ambiguous approach to global financial governance’ *Development and Change* 50 (1): 221–244.

World Bank (2015) ‘Development banks working together to optimize balance sheets’. Press release, 22 December. Washington DC: World Bank.

World Bank (2020) ‘International Development Association project appraisal document on a proposed credit in the amount of US$400.0 Million from the Scale-Up Facility and a Proposed Credit in the Amount of US$15.0 million to the Eastern and Southern African Trade and Development Bank’. Project Appraisal Document, 9 June. Washington DC: World Bank.

Appendix 1 Additional data on borrower-led MDBs

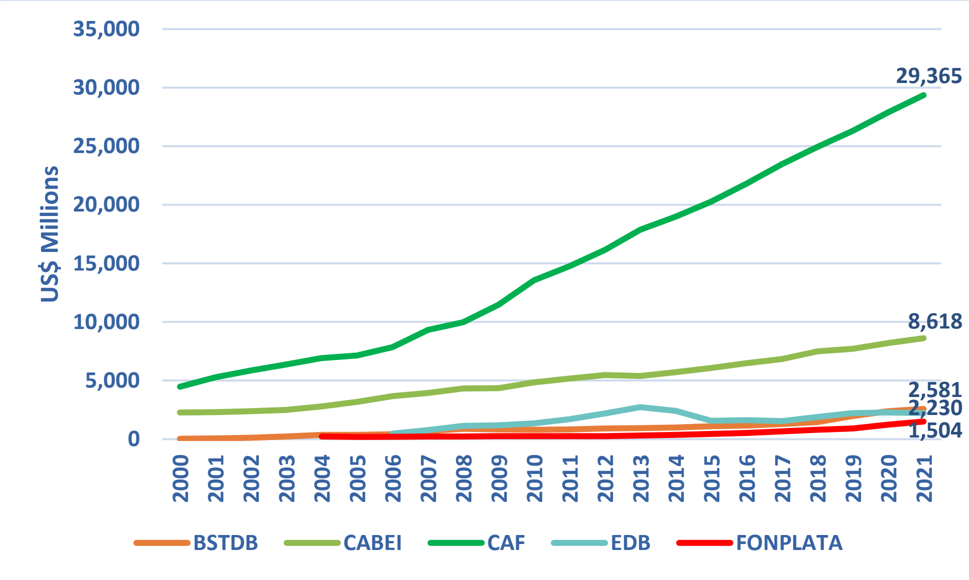
Figure 6 Growth of African MDB loan portfolios (2000–2021)



Note: All of these MDBs were founded prior to 2000, but time series loan portfolio data for the entire period are only available for Afreximbank.

Source: MDB annual financial statements, 2000–2021

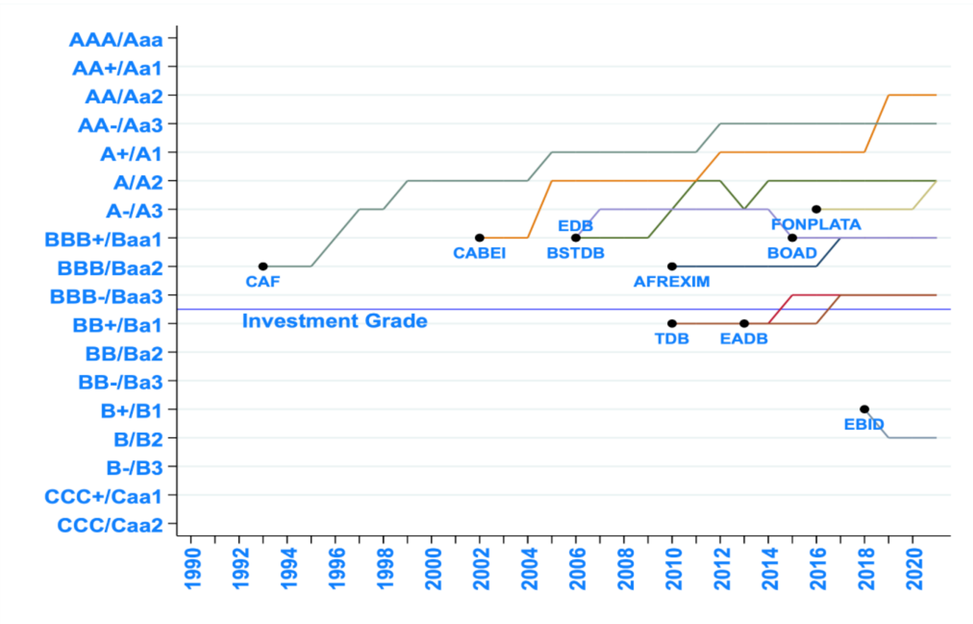
Figure 7 Growth of Latin American, Eastern European and Central Asian MDB loan portfolios (2000–2021)



Note: EDB was founded in 2006, with complete time series loan portfolio data available. FONPLATA was founded prior to 2000, but time series loan portfolio data are available only as of 2004.

Source: MDB annual financial statements, 2000–2021

Figure 8 Evolution of borrower-led MDB bond ratings (1993–2021)



Note: The data points denote when an MDB had a rating from either S&P or Moody's. When both agencies rated the MDB, and the rating was not the same, the higher value is represented in the figure.

Source: S&P and Moody's ratings reports